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JUN 29 1995

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

Price Cap Performance Review )  
for Local Exchange Carriers )

CC Docket No. 94-1

OPPOSITION TO PETITIONS FOR RECONSIDERATION

BellSouth Telecommunications, Inc. ("BellSouth"), through undersigned counsel, hereby opposes the Petitions for Reconsideration ("PFRs") filed on May 19, 1995 by MCI Telecommunications Corporation ("MCI"), AT&T Corp. ("AT&T"), and the Ad Hoc Telecommunications Users Committee ("AD Hoc"). The PFRs seek reconsideration of the Performance Review Order<sup>1</sup> released April 7, 1995. Notice of the PFRs was published in the Federal Register on June 14, 1995. 60 Fed. Reg. 31308.

The United States Telephone Association ("USTA") comments demonstrate conclusively that the PFRs are without merit and should be denied. BellSouth participated in the development of the USTA comments, and will not duplicate the arguments advanced therein, but will provide additional reasons for denying the PFRs.

- I. MCI's attack on 4.0 percent as the lowest productivity offset is without merit.

MCI claims that the lower 4.0 percent productivity offset is inconsistent with a Commission finding of

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<sup>1</sup>In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, FCC 95-132, released April 7, 1995 ("Performance Review Order").

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increased LEC productivity and with the Commission's determination to incorporate productivity changes that have occurred since the institution of price cap regulation.<sup>2</sup> MCI quotes selectively from the Commission's order to reach a totally misleading premise.

MCI cites paragraph 221 of the Performance Review Order for the proposition that LEC productivity has increased during the first four years under price caps. In fact, paragraph 221 describes LECs likely to choose the optional 4.7 percent productivity offset. The Commission speculated that those LECs likely "can achieve the productivity growth implied by this [4.7 percent] X-Factor."<sup>3</sup> By contrast, the LECs expected to select the 4.0 percent productivity offset were described in paragraph 222 of the order. For those LECs that "have lagged behind other LECs in their performance under price caps, for whatever reason, this minimum X-factor establishes a conservative offset, since it is based on LEC performance data from cost-of-service years."<sup>4</sup> Thus, the Performance Review Order provides no support for MCI's assertion that a 4.0 percent X-factor is too low for the least productive LECs.

The Commission drastically truncated the 50/50 sharing range for LECs selecting the 4.0 percent productivity

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<sup>2</sup>MCI PFR at 3.

<sup>3</sup>Performance Review Order at para. 221.

<sup>4</sup>Performance Review Order at para. 222.

offset. Also, in Docket 93-179, the Commission adopted an "add-back" requirement that imposes significant financial penalties for carriers incurring a sharing obligation.<sup>5</sup> These changes provide LECs with powerful financial incentives to select a higher productivity offset during the period the interim plan remains in effect. The fact that several LECs nevertheless selected the 4.0 percent productivity offset in their 1995 annual access tariff filing refutes MCI's claim that the minimum productivity offset should have been raised to 5.7 percent.<sup>6</sup>

MCI cites paragraph 145 of the Performance Review Order for the proposition that the productivity offset should incorporate the productivity changes that have occurred since the institution of price cap regulation. Paragraph 145 describes the Commission's intent with regard to the permanent productivity offset to be determined in the next phase of this docket. The Commission expressly disclaimed having sufficient data to determine the price cap

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<sup>5</sup>In the Matter of Price Cap Regulation of Local Exchange Carriers: Rate of Return Sharing and Lower Formula Adjustment, CC Docket No. 93-179, Report and Order, FCC 95-133, released April 14, 1995.

<sup>6</sup>MCI PFR at 5. The Commission should draw no conclusions about the viability of a 5.3 percent productivity offset over the long-term based on the selection of that offset level by several carriers, including BellSouth, during the interim plan. The fact that a carrier believes that it can sustain a high level of productivity over a one or two year period does not mean that it can withstand the cumulative impact of a high productivity offset in the long term.

productivity of the LECs at this time.<sup>7</sup> Thus, there is no inconsistency between the Commission's findings and its selection of 4.0 as the minimum productivity offset for the interim plan.

II. The 5.3 percent upper productivity offset is not too low.

MCI, AT&T and Ad Hoc all argue that there was sufficient record evidence to support an upper productivity offset higher than 5.3 percent. They cite no defect in the Commission's analysis of the record, but rather simply ask the Commission to change its mind.

AT&T cites an ex parte letter it submitted to the Commission for the proposition that "the LECs have achieved an aggregate productivity of 5.54 percent" since the inception of price caps.<sup>8</sup> The Commission correctly declined to set the interim productivity offset based on the AT&T analysis. AT&T's analysis is not a study of productivity at all. It is simply a mathematical exercise to answer the question, "What X-factor would have been necessary to limit the earnings of the price cap LECs to 11.25 percent?" BellSouth respectfully submits that AT&T's model is wholly inappropriate for use in price cap regulation. It implies that the LECs can sustain the efficiency gains achieved in the first price cap period into perpetuity--an implication

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<sup>7</sup>Performance Review Order at para. 144.

<sup>8</sup>AT&T PFR at 3.

that AT&T makes no effort to prove and which the price cap LECs expressly refuted on the record.<sup>9</sup> It also implies that it is inappropriate for price cap LECs to improve their earnings commensurate with their improved productivity. As such, it is inconsistent with the efficiency incentives that price cap regulation was designed to stimulate. The Commission was clearly correct when it tentatively concluded that total factor productivity should be used to determine the X-factor in the LEC price cap plan.<sup>10</sup>

Even taken at face value, AT&T's proposal in this proceeding does not support its argument that the 5.3 percent productivity offset is too low. AT&T calculated the achieved X-factor of the price cap LECs at 5.54 percent during the initial price cap period.<sup>11</sup> AT&T also recommended that the Commission reduce its calculated amount by 0.5 percent to provide LECs with a "productivity dividend" to encourage them to continue to perform efficiently.<sup>12</sup> Thus, the net productivity offset that flows from AT&T's recommendations is 5.04 percent--below the 5.3 percent imposed by the Commission.

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<sup>9</sup>See, e.g., BellSouth Comments at 34-37 (May 9, 1994); BellSouth Reply Comments at 23 (June 29, 1994).

<sup>10</sup>Performance Review Order at paras. 155, 163.

<sup>11</sup>Performance Review Order at para. 130.

<sup>12</sup>Performance Review Order at para. 128.

Ad Hoc argues that the Commission erred in relying on USTA's updated and corrected TFP data to set the 5.3 percent interim upper productivity offset. Aside from offering no legal or logical reasons why the Commission should not use updated and corrected data, Ad Hoc appears simply to have misread the Commission's order.

The Commission reached its conclusion that the minimum productivity offset should be raised to 4.0 percent by eliminating the 1984 data point from the original Frentrup-Uretsky study.<sup>13</sup> It also found that if it simply extrapolated from the original plan, it would set the upper productivity offset at 5.0 percent.<sup>14</sup> The Commission found, however, that many LECs with relatively high earnings continued to opt for the 3.3 percent productivity offset because the risk associated with a permanent one percent reduction in the PCI was too large in comparison with the one year relaxation of the sharing thresholds.<sup>15</sup> The Commission also made a policy choice to include at least one option that eliminated sharing as "a cautious, but still significant, step toward our tentative conclusion that sharing should be eliminated at the earliest feasible opportunity."<sup>16</sup> The Commission therefore established "two

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<sup>13</sup>Performance Review Order at paras. 208-209.

<sup>14</sup>Performance Review Order at para. 210.

<sup>15</sup>Performance Review Order at para. 212.

<sup>16</sup>Performance Review Order at para. 211.

optional X-Factors at equal intervals above and below that [5.0 percent] level", 4.7 percent and 5.3 percent.<sup>17</sup>

Nowhere does the Commission rely on the updated USTA study to justify these findings.<sup>18</sup> Ad Hoc simply misrepresents the Commission's order and then attacks its own strawman.

III. The Commission correctly included a "no-sharing" option in the interim LEC price cap plan.

MCI, AT&T and Ad Hoc all attack the Commission's decision to include a "no-sharing" option in the interim LEC price cap plan. The Commission's decision was amply supported in the record and adequately explained in the Performance Review Order. The Commission discussed at length the damage that sharing does to the incentive structure of the LEC price cap plan, and the substantial evidence in support of the elimination of sharing.<sup>19</sup> The Commission made a policy choice to offer a no-sharing option to those LECs willing to undertake a substantial increase in the productivity offset.<sup>20</sup> None of the petitioners has

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<sup>17</sup>Performance Review Order at para. 214.

<sup>18</sup>The Commission cited the updated USTA study for the proposition that the study, when adjusted for an input price differential, corroborated the Commission's decision to eliminate the 1984 data point from the Frentrup-Uretsky study. See Performance Review Order at para. 207. BellSouth will address the issues associated with an input price differential in its comments in response to the Further Notice anticipated in this proceeding.

<sup>19</sup>Performance Review Order at paras. 184-197.

<sup>20</sup>Performance Review Order at para. 214.

offered any plausible reason for the Commission to reconsider that policy choice.

Ad Hoc engages in a tirade because the Commission has rejected its repeated attempts to read into the Communications Act a requirement to regulate carriers' earnings rather than their rates.<sup>21</sup> MCI also alleges that the Commission has a statutory responsibility under Section 201 of the Communications Act to limit carriers' earnings.<sup>22</sup> MCI's position is particularly curious, since it is a carrier subject to Section 201 of the Communications Act, and the Commission does not regulate its earnings. AT&T is a dominant carrier subject to Section 201, and the Commission does not regulate its earnings. Cable television companies are subject to a just and reasonable rate standard identical to Section 201, and yet the Commission does not regulate their earnings under the cable price cap plan. Clearly, it is MCI and Ad Hoc, not the Commission, that are trying to "re-write the Communications Act".<sup>23</sup> The Commission has made a permissible policy choice to include a no-sharing option in the interim LEC price cap plan. MCI and Ad Hoc have shown no reason for the Commission to reconsider that choice.

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<sup>21</sup>Ad Hoc PFR at 6-10.

<sup>22</sup>MCI PFR at 13.

<sup>23</sup>MCI PFR at 14.



IV. The Commission correctly refused to make a one-time index adjustment or to recalibrate the sharing bands based on alleged changes in the LECs' cost of capital.

AT&T asks the Commission to adopt a one-time index adjustment to reflect an alleged decrease in the LECs' cost of capital.<sup>24</sup> MCI asks the Commission to recalibrate the sharing bands due to alleged capital cost decreases.<sup>25</sup> The Commission was correct in rejecting these proposed adjustments in the Performance Review Order, and it should likewise reject these reconsideration requests.

AT&T contends that the LECs cost of capital declined by 132 basis points between 1991 and 1993.<sup>26</sup> MCI contends that the Commission ignored evidence of a decline in equity costs.<sup>27</sup> Both MCI and AT&T simply ignore clear and convincing evidence offered by BellSouth and other LECs that the alleged decline in equity capital costs was illusory, and that the decline in debt costs was funded by LEC shareowners, and thus should inure to the shareholders' benefit.

Specifically, BellSouth demonstrated that 1) capital cost changes affect the entire economy, and are reflected in the GNP-PI; 2) capital costs are only one component of a firm's cost of production, and should not be singled out for

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<sup>24</sup>AT&T PFR at 5.

<sup>25</sup>MCI PFR at 14-15.

<sup>26</sup>AT&T PFR at 5.

<sup>27</sup>MCI PFR at 15.

unique treatment under price cap regulation; 3) a comparison of the DCF calculations performed by the Commission in 1990 and the 1993 calculations of AT&T imply only a 28 basis point reduction in the cost of equity; 4) the evidence submitted by Matthew Kahal, MCI's expert, in Docket 89-624 and in this proceeding shows no decline in the cost of equity; and 5) reductions in the embedded cost of debt were largely due to refinancing activity funded by shareowners, not ratepayers.<sup>28</sup> MCI and AT&T do not address, much less refute, these showings. When coupled with the subsequent rise in capital costs<sup>29</sup>, it is clear that the Commission cannot, and should not, reverse itself on this issue.

V. Conclusion.

USTA has completely refuted the allegations made in the PFRs of AT&T, MCI and Ad Hoc. In addition, BellSouth shows herein that there is no inconsistency in the Commission's rationale for selecting 4.0 percent as the lowest productivity offset, the 5.3 percent upper productivity is not too low, the Commission correctly included a "no-sharing" option in the LEC price cap plan, and the

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<sup>28</sup>BellSouth Reply Comments at 14-20 (June 29, 1994).

<sup>29</sup>Performance Review Order at para. 231.

Commission correctly refused to make interim changes in the LEC price cap plan due to alleged changes in LEC capital costs. The PFRs should be denied.

Respectfully submitted:

BELLSOUTH TELECOMMUNICATIONS, INC.

By its attorney:

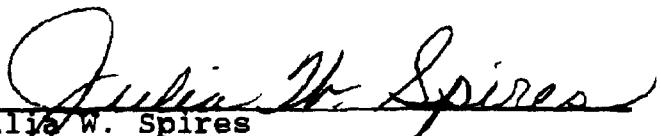
A handwritten signature in cursive script, appearing to read "M. Robert Sutherland", is written over a horizontal line.

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June 29, 1995

CERTIFICATE OF SERVICE

I hereby certify that I have this 29th day of June, 1995, serviced all parties to this action with the foregoing OPPOSITION TO PETITIONS FOR RECONSIDERATION reference to Docket CC 94-1, by hand delivery or by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties as set forth on the attached service list.

  
Julia W. Spires

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